Legislative Audit Division

State of Montana

Report to the Legislature

December 2000

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 2000

Department of Revenue

This report contains eight recommendations to the department. Major issues addressed in this report include:

- **Properly accounting for coal tax income distributions.**
- **Reconciliation of primary accounting records.**
- **Problems related to the revenue processing system due to implementation and/or deficiencies in the design and operation of POINTS.**
- **Customer service center internal service fund.**
- **Unemployment insurance contract compliance.**

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 1999, was issued on March 30, 2000. The Single Audit Report for the two fiscal years ended June 30, 2001, will be issued by March 31, 2002. Copies of the Single Audit Report, when available, can be obtained by contacting:

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December 2000

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Revenue for the two fiscal years ending June 30, 2000. We issued a qualified opinion on the financial schedules of the department. Included in this report are eight recommendations to the department. The department's response is located at the end of the report.

We thank the director and staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

(Signature on File)

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Legislative Audit Division

Financial-Compliance Audit
For the Two Fiscal Years Ended June 30, 2000

Department of Revenue

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Department of Revenue

This report documents the issues noted during our financial-compliance audit of the Department of Revenue for the two fiscal years ended June 30, 2000. The previous audit report contained six recommendations. The department implemented all six of the recommendations. This report contains eight recommendations directed to the department.

We issued a qualified opinion on the financial schedules presented in this report. This means the reader should use caution when relying on the presented financial information and the supporting detailed information on the primary accounting records.

The listing below serves as a means of summarizing the recommendations contained in the report, the department's response thereto, and a reference to the supporting comments.

Recommendation #1

We recommend the department establish controls to properly account for coal tax income distributions, record UI expenditures, and estimate revenue accruals to ensure compliance with state law and accounting policy . . . . Page 14

Department Response: Partially Concur. See page B-3.

Recommendation #2

We recommend the department perform complete and timely reconciliations between the primary accounting records and POINTS to ensure the completeness and accuracy of the accounting records. . . . . Page 16

Department Response: Concur. See page B-4.

Recommendation #3

We recommend the department deposit receipts as required by state law. . . . . Page 17

Department Response: Concur. See page B-4.

Recommendation #4

We recommend the department comply with state law by issuing refunds or credits to employers that overpay Unemployment Insurance taxes. . . . . Page 18

Department Response: Concur. See page B-5.

<u>Recommendation #5</u>

We recommend the department:

A. Assess penalties and interest for UI in compliance with state law.

B. Analyze activity in the Special Revenue Penalty and Interest Fund to identify and make necessary adjustments to correct the accounting records. . . . . Page 19

<u>Department Response</u>: Concur. See page B-5.

<u>Recommendation #6</u>

We recommend the department comply with federal law related to the immediate deposit of UI receipts in the U.S. Treasury clearing account. . . . . Page 20

<u>Department Response</u>: Concur. See page B-5.

<u>Recommendation #7</u>

We recommend the department:

A. Reasonably estimate volumes when calculating ISF rates to ensure rates are commensurate with costs.

B. Charge for actual services provided to all customers using approved rates. . . . . Page 23

<u>Department Response</u>: Concur. See page B-5.

<u>Recommendation #8</u>

We recommend the department:

A. Comply with its UI tax collection, reporting, and monitoring agreements with the DOLI.

<u>Department Response</u>: Concur. See page B-6.

B. Comply with state law regarding spending non-general fund money first.

<u>Department Response</u>: Concur. See page B-7.

C. Comply with state policy related to expenditure accruals. . . . . Page 26

<u>Department Response</u>: Partially Concur. See page B-7.

Introduction

Introduction

We performed a financial-compliance audit of the Department of Revenue (department) for the two fiscal years ended June 30, 2000. The objectives of our audit were to:

1. Determine if the department complied with applicable state and federal laws and regulations.

2. Obtain an understanding of and, if appropriate, make recommendations for improvement in the internal and management controls of the department.

3. Determine the implementation status of prior audit recommendations.

4. Determine if the department's financial schedules present fairly the results of its operations for each of the two fiscal years ended June 30, 2000.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the costs, if significant, of implementing recommendations contained in this report. Other items deemed not to have significant effect have been discussed with management.

As required by section 17-8-101(6), MCA, we analyzed the rates charged and fund equity on the department's Internal Service Fund. Our finding in this area is presented beginning on page 21.

Department Organization and Functions

The department collects revenue from and enforces regulations for over 30 state taxes and fees. Some of the state taxes collected include income, corporation, natural resource, accommodation, unemployment insurance, and inheritance. The department also regulates the sale and distribution of alcoholic beverages in the state. Total revenue by class, as recorded by the department, is identified on page 2 for each of the two fiscal years ended June 30, 1999 and 2000.

Total Revenue

Total Revenue by Class (in thousands)	**FY 1998-99**	**FY 1999-00**
Licenses and Permits	$ 8,203	$ 8,446
Taxes	975,022	991,245
Charges for Services	4,793	11,487
Investment Earnings	20,387	27,461
Fines and Forfeits	732	427
Federal Indirect Cost Recovery	13	11
Sale of Documents, Merchandise and Prop.	36,994	40,794
Contributions and Premiums	4,714	5,580
Miscellaneous	90	670
Grants, Contracts, Donations and Abandonments	1,386	2,037
Other Financial Sources	85,003	120,421
Federal	20,406	13,625
Total	**$1,157,743**	**$1,222,204**

Source: Compiled by the Legislative Audit Division from Department accounting records.

The following is the current organizational structure of the Department of Revenue including full-time equivalent (FTE) positions:

The **Director's Office** advises the Governor on all matters affecting the department, recommends changes to Montana tax laws and policies, provides policy direction to all department processes, and develops and presents the department's biennial budget. The director's office is composed of four sections and has 38.5 authorized FTE.

1. **Dispute Resolution** reviews, facilitates, and resolves taxpayer disputes internally through a variety of means, including mediation.

2. **Office of Legal Affairs** supervises the overall legal efforts of the department, supervises the staff attorneys, and maintains liaison with retained attorneys.

3. **Policy and Performance Management (PPM)** provides policy direction, strategic planning, administrative rules, and performance management for department operations. It measures and facilitates the performance of department processes and ensures that revenue-related legislation is implemented efficiently.

4. **Tax Policy and Research (TPR)** is responsible for estimating state general fund revenues, coordinating Department of Revenue legislation, preparing fiscal notes for most tax-related legislation, and reviewing all legislation which is related to revenue. TPR also analyzes economic and statistical data, compiles department research data, and conducts revenue-related research for the department and for external stakeholders.

Division Descriptions

Information Technology (IT) provides computer services for data support, applications support, technology support, and user assistance (37.25 FTE).

Resource Management (RM) integrates human resources, accounting, facilities, internal and external customer education, and liquor distribution into a division that focuses on service and support (43 FTE).

Compliance, Valuation, and Resolution (CVR) oversees audits and other measures to verify tax-paying entities are in compliance with the laws. CVR also establishes values of property for purposes of taxation. The division is located throughout the state in eight regions to provide customer service (419.81 FTE).

Customer Service Center (CSC) combines the document and information processing, accounts receivable and collections, and customer intake processes into a single business unit designed to collect revenue and process documents for the department and other agencies (127.20 FTE). This process is divided into three subprocesses including:

1. **Customer Intake** is the initial contact point for customers and is the central point for the development and design of forms and instructions. Customer Information Consultants are supported by

up-to-date technology, enabling them to answer customer inquiries for all tax types.

2. **Document & Information Processing** is responsible for electronic commerce, document capture, remittance processing, records management, deposit of cash receipts, and mail distribution.

3. **Accounts Receivable & Collections** is a single point of contact for debtors and is responsible for delinquent account collection and enforcement activities.

Prior Audit Recommendations

Prior Audit Recommendations

The financial-compliance audit report of the department for the two fiscal years ended June 30, 1998, contained six recommendations and one disclosure issue. We determined the department implemented all of the prior audit recommendations.

Findings and Recommendations

Control Structure

The issues discussed in the first six recommendations of this report may have been prevented or detected in a timely manner by implementation of appropriate control and monitoring procedures. Reorganization of the department, conversion to a new integrated computer system, conversion to a new statewide accounting system, and turnover of personnel all contributed to the issues discussed in these sections. Department officials indicated they have spent considerable time and attention in the last year implementing various policies and procedures to improve their control structure. We did not review all control systems and we believe the department could implement these recommendations and continue to have other similar types of errors. Now that the department has finished its reorganization, the department should continue to implement and communicate control and monitoring procedures to ensure it will achieve its objectives related to financial accountability and compliance with laws and regulations.

Compliance with State Accounting Law and Policy

State law, section 17-1-102(4), MCA, requires recording the receipt, use, and disposition of all public money and property on the accounting system, by fiscal year-end, in accordance with Generally Accepted Accounting Principles (GAAP). The Accounting and Management Support Division of the Department of Administration issues accounting rules to ensure state accounting policy complies with GAAP. Accounting for financial activity in accordance with these requirements improves the quality, consistency and comparability of the resulting financial information among state agencies. It also ensures revenues and expenditures are properly and consistently measured each fiscal year.

The following report section discusses accounting errors we found during our audit. Each of the seven issues results in misstatements on the accounting records of at least $1 million.

Findings and Recommendations

Permanent Coal Severance Tax Trust Investment Fund

State law requires that all income from the permanent coal severance tax trust fund be deposited to the General Fund. During fiscal year 1999-00, we noted the department made several errors on transactions to transfer and record the investment activity to the General Fund as required by state law. The net effect of these errors results in the understatement of the Permanent Coal Severance Tax Nonexpendable Trust Fund fund balance by $27.1 million and the General Fund fund balance is overstated by $27.1 million. The most significant error relates to the transfer of unrealized investment gains and losses and is discussed below.

Governmental Accounting Standards Board (GASB) statement 31 requires the state to recognize as income (or negative income) unrealized market gains and losses on investments. Unrealized gains and losses are the difference between the book value and market value of investments at the balance sheet date. The Montana Board of Investments (BOI) personnel input transactions to the state's accounting system to record this activity during the fiscal year-end closing process. For accounts under its control, the department then must distribute the income to the proper funds.

The difference between book and market value for the permanent coal severance investments was a $17.6 million decrease at June 30, 2000, compared to June 30, 1999. As a result, BOI personnel input a transaction to reflect the $17.6 million unrealized loss as negative income. Department personnel made the entries to distribute the decrease in value during the fiscal year-end period. However, when the entries were made the decrease in value of investments was recorded on the accounting records as if an increase had occurred which doubled the effect of the transaction. This error caused nonbudgeted transfers-out of the Nonexpendable Trust Fund to be overstated by $35.2 million and nonbudgeted transfers-in to be overstated in the General Fund by the same amount.

Resource Indemnity Trust Fund

While agency personnel were researching the issues above, they noted that similar types of errors occurred in the transactions to transfer income from the Nonexpendable Resource Indemnity Trust Fund (RITT) to several Special Revenue Funds. The errors caused a net understatement of fund balance of $6 million in the Nonexpendable Trust Fund and a corresponding overstatement of fund balance in the Special Revenue Funds.

The most significant error related to recording a decrease in the market value of investments as an increase when distributing the negative unrealized income. As a result, nonbudgeted transfers-out of the Nonexpendable Trust Fund are overstated by $8.2 million and nonbudgeted transfers-in in the Special Revenue Funds are overstated by the same amount.

Summary

Department personnel stated the individual who had historically prepared the distribution documents left the department in May 2000 and the personnel who were responsible for the entries did not recognize that the adjustments for the effects of GASB #31 were for a decline in value rather than an increase. A supervisory review of the distribution transactions should have detected these errors.

As a result of the two issues discussed above, we believe users of the department's financial information could be misled. The June 30, 2000, Nonexpendable Trust Fund fund balance is understated by $33.1 million, General Fund fund balance is overstated by $27.1 million, and Special Revenue Fund fund balance is overstated by $6.0 million on the state's accounting records. Consequently, we issued a qualified audit opinion on the department's financial schedules as described in the Independent Auditor's Report on page A-3.

Findings and Recommendations

U.S. Mineral Royalty

U.S. mineral royalty revenues are received monthly by electronic transfer to the treasury unit of the Department of Administration (DOA). Once these funds have been received it is the department's responsibility to record the receipt of the revenue on the accounting records. In April and June of fiscal year 1999-00, receipts of $1,394,988 and $1,880,561, totaling $3.2 million, were not recorded on the accounting records. Since the funds are the responsibility of the department and are received on a regular basis, we believe department personnel should have followed up with DOA before the close of the fiscal year to determine the status of the collections. A timely review of the accounting records should have detected this omission. As a result, fiscal year 1999-00 General Fund federal revenues and cash are understated by $3.2 million on the accounting records.

UI Expenditures

During fiscal years 1998-99 and 1999-00, the department recorded most expenditures related to collecting and monitoring Unemployment Insurance (UI) taxes in the General Fund as salaries, benefits, travel, and supplies when incurred. The expenditures were later moved to a federal Special Revenue Fund. However, when the expenditures were moved, they reduced the "other" operating expenditure classifications in fiscal year 1998-99 and "consultants and professional services" operating expenditure classification in fiscal year 1999-00 in the General Fund. Those same expenditure classifications were increased in the federal Special Revenue Fund.

We believe neither classification is in compliance with state accounting policy, is not consistent with how other similar expenditures are recorded, and misstates those expenditure classifications by fund. The expenditures associated with administering the UI function should be no different than expenditures of administering any of the other taxes at the department, regardless of whether they are performing the work as part of an agreement with another state agency. The expenditures should be recorded based on type as provided in the ICC indexes for fiscal year 1998-99 and the Statewide Accounting, Budgeting, and Human Resource System (SABHRS) accounts for fiscal year 1999-00. When the expenditures were moved from the General

Fund to the federal Special Revenue Fund, they should have used the same classification as when they were originally recorded. For example, salaries paid to personnel administering UI taxes should be charged to salaries.

As a result, fiscal year 1998-99 expenditures of $1.3 million are misclassified and expenditures of $1.7 million are misclassified in fiscal year 1999-00 in the General Fund and federal Special Revenue Fund. Department personnel stated it was easier to track the UI expenditures in the miscellaneous and other service categories and believe recording the expenditures as "consultants and professional services" operating expenditure classification is appropriate since they perform the work as part of an agreement with another state agency.

Revenue Accruals

During the fiscal year-end process, department accounting personnel record transactions to estimated revenue, accounts receivable, deferred revenue, and allowance for doubtful accounts for most tax types as required by state accounting policy. We noted the following errors occurred during this process in fiscal year 1998-99 and 1999-00. A supervisory review of these transactions before the end of the fiscal year should have prevented or detected these errors.

Coal Severance Tax Accrual

At fiscal year-end 1999-00, an accrual for expected revenue from the coal severance tax was reduced by $6 million for an anticipated refund to one taxpayer. A subsequent transaction in fiscal year 2000-01 to reverse the reduction of revenue and receivables was recorded without any written documentation explaining the reason for the transaction.

The refund was related to a 1992 audit of a company that resulted in the determination that there had been an overpayment (refund) on a portion of the taxes calculated. In the same audit, a determination was made on a different issue that the company had underpaid its taxes. The company eventually appealed the underpayment determination to the state Supreme Court. The overpayment was not part of the company's appeal. However, during the time the appeal was in process the department held the overpayment due the company because they believed the company owed the state more than the

amount of the overpayment. In a decision, issued in May 2000, the state Supreme Court agreed with the company and stated there was no additional tax due. As a result, department personnel responsible for calculating the accrual believed the department would either pay the company the refund or offset the refund against future tax liability for the company. As a result the revenue accrual was reduced by the $6 million refund owed to the company.

During September of fiscal year 2000-01, the department processed a transaction to reverse the $6 million dollar revenue and accounts receivable reduction without any written documentation of the reason for the transaction. Department management indicated the subsequent transaction was the result of management's review of the accrual. Management believes that since the company had not requested a refund, the statute of limitations had been reached, and the company was no longer entitled to a refund. As a result, department management believes that fiscal year 1999-00 revenue and accounts receivable in the Nonexpendable Trust Fund are understated by $6.0 million. We believe that, as part of a good control structure, the department should have written documentation before entering transactions of this magnitude on the accounting records. A timely review of the initial transaction may have detected the error before fiscal year-end.

Inheritance Tax Accrual

During fiscal year-end 1998-99, department personnel made errors when recording the transactions to defer revenue and adjust the allowance for doubtful accounts for inheritance taxes. In both cases, revenues were debited rather than accounts receivable. As a result, both accounts receivable and budgeted revenue are understated in the General Fund by $3.8 million in fiscal year 1998-99.

Withholding Tax Accrual

While calculating the withholding tax accrual during fiscal year-end 1999-00, personnel made an error that resulted in the accrual being overstated by $1.29 million. Personnel said that when calculating the accrual an incorrect amount was used from supporting documents. As a result, tax revenue and accounts receivable are overstated by $1.29 million in the General Fund.

The following table summarizes the accounting record misstatements discussed above.

Summary of Accounting Record Misstatements

Issue	Fund(s) Affected	Account(s) Affected	Misstatements Fiscal Year 1998-99	Misstatements Fiscal Year 1999-00
Coal Severance	Nonexpendable Trust Fund	Nonbudgeted Transfer-Out		$33.1 million
	General Fund	Nonbudgeted Transfer-In		$27.1 million
	Special Revenue Fund	Nonbudgeted Transfer-In		$ 6.0 million
U.S. Mineral Royalties	General Fund	Federal Revenue		$ 3.2 million
		Cash		$ 3.2 million
UI Expenditures	Special Revenue Fund	Various Expenditure Objects	$1.3 million	$ 1.7 million
Inheritance Tax Accrual	General Fund	Tax Revenue	$3.8 million	
		Accounts Receivable	$3.8 million	
Withholding Tax	General Fund	Tax Revenue		$ 1.29 million
		Accounts Receivable		$ 1.29 million

Source: Compiled by the Legislative Audit Division

The net effect on fund balance by fund for these errors is as follows:

- Fiscal year 1998-99 General Fund fund balance is understated by $3.8 million.
- Fiscal year 1999-00 General Fund fund balance is overstated by $25.19 million.

- Fiscal Year 1999-00 Special Revenue Fund fund balance is overstated by $6.0 million.
- Fiscal year 1999-00 Nonexpendable Trust Fund fund balance is understated by $33.1 million.

Although several of these errors were identified by department personnel, the identification was after the fiscal year-end close of the accounting records. We believe errors on the financial records of the magnitude identified above should have been detected or prevented by controls designed to ensure the accuracy of financial information before the close of the accounting records. Some of these controls include cross training of personnel, supervisory review of transactions, timely review of accounting records, and a review of fiscal year-end transactions.

Recommendation #1
We recommend the department establish controls to properly account for coal tax income distributions, record UI expenditures, and estimate revenue accruals to ensure compliance with state law and accounting policy.

Process Oriented Integrated System

The department implemented phase I of its Process Oriented Integrated System (POINTS) on December 8, 1999. POINTS is designed to provide integrated information concerning the department's customers across tax types for registration, accounting, return processing, forms, correspondence, and case management. During fiscal years 1998-99 and 1999-00, the department spent approximately $17 million on the POINTS system. POINTS replaced the Delinquent Accounts Receivable System, Montana Automated Contribution System, Magnetic Media Reporting System, Employer Withholding Tax System, Refund and Confiscation System, Electronic Commerce System, and the Revenue Control System.

Primary Accounting Record Reconciliations

We found the department does not have adequate control procedures in place to ensure that information from POINTS is accurately and completely recorded on the primary accounting records. The lack of control procedures includes not having any documentation to demonstrate whether the correct amount of collections on POINTS are deposited on a daily basis to the state's treasury.

Reconciliations of primary accounting records to subsidiary systems are essential to a complete control structure. POINTS data is transferred to the primary accounting records using three key interface programs. No complete reconciliations were performed between POINTS and the primary accounting records during fiscal year 1999-00 to ensure all POINTS financial information was being recorded on the accounting records completely and accurately.

We also noted during work performed by our information system auditors that the department has not been monitoring SABHRS reports that list POINTS financial information that was rejected. Review of these reports is necessary to ensure completeness since the primary accounting records will not process rejected records until they are corrected and resubmitted. Accounting personnel were not aware that the reports existed and personnel who knew about the report thought that accounting personnel were reviewing it. Without review of the exception reports, the department has no means to detect on a timely basis POINTS records that were not completely transferred to the primary accounting records.

Accounting personnel were aware of the importance of reconciling POINTS to the accounting records but were unable to get the information from POINTS necessary to perform a reconciliation. When the information was finally received it was during the fiscal year-end closing process and they did not have the time to complete the reconciliation. In addition, without reviewing the daily exception reports and resubmitting any rejected transactions to the accounting records, any reconciliation process would be much more difficult.

As a result of the reconciliation not being completed and necessary corrections processed, department records were identified as one of the reasons the treasury unit of the Department of Administration was unable to reconcile the accounting records to the state's bank accounts by the end of fiscal year 1999-00. Since that time the department personnel have started a reconciliation of amounts shown as collections on POINTS to the amounts deposited in the state treasury. Adjustments have been identified which are necessary to correct the accounting records.

The department should implement additional control procedures to ensure the timely detection of incomplete or inaccurate information on the accounting records. These control procedures should include a timely and complete reconciliation between POINTS and the accounting records and a review of the daily exception reports.

Recommendation #2
We recommend the department perform complete and timely reconciliations between the primary accounting records and POINTS to ensure the completeness and accuracy of the accounting records.

Revenue Processing

The following four report sections discuss issues we found that are directly related to the design, implementation, and operation of POINTS. All of these issues could have been prevented through implementation of control procedures to ensure timely deposits and communication of the unique aspects of UI cash accounts that led to the issues related to Unemployment Insurance (UI) refunds, UI penalty and interest, and deposit of UI funds. In addition, the issues discussed on page 24 and 25 of this report related to not providing information necessary for federal reporting and delays in billing the Department of Labor and Industry for UI audits were caused by problems with POINTS.

Daily Deposits

State law, section 17-6-105, MCA, requires that all collections be deposited each day when cash exceeds $100 or total collections exceed $500. During our audit we found the department was not in compliance with this law. We tested 3 collection reports, prepared in May and June 2000, with 44 batches totaling $129,650 that were deposited from 4 days up to 2 months after receipt. Of the 44 batches, 23 were deposited one month or more after receipt.

Daily deposits are essential to a good internal control structure designed to reduce the chance for theft or loss to occur. In addition, funds not deposited are not invested, which results in a loss of interest income to the state. Department personnel stated the delay in deposits resulted because of a problem in POINTS that was fixed in March. The department should ensure all receipts are deposited in accordance with state law.

Recommendation #3
We recommend the department deposit receipts as required by state law.

Unemployment Insurance

The department performs the tax collection and revenue administrative functions for the Unemployment Insurance tax (UI). This function is assigned to the department by state statute. The Montana Department of Labor and Industry (DOLI) receives federal funds to pay for administering the UI program. DOLI pays the department through a contract for the administration of the tax function. The following three issues address areas where the department is not in compliance with two state and one federal law related to UI tax administration.

Unemployment Insurance Refunds

Since POINTS was implemented in December 1999, the department has not been able to pay refunds required by state law to employers who overpaid their UI taxes. When employers overpay their UI taxes, state law provides the department can either issue the employer a refund or apply it to their account as a credit against future tax liabilities.

We reviewed a file of refunds and noted that at least 25 employers have specifically requested a refund. Of those 25, three were from employers who are no longer filing UI taxes in the state of Montana so the option of crediting those employers account with the refund does not exist.

Department personnel said a problem in the accounting module of POINTS does not allow refunds to be processed. Personnel told us they are currently correcting the problem that would allow refunds to be issued, and they have issued some refunds on a case-by-case basis.

Recommendation #4
We recommend the department comply with state law by issuing refunds or credits to employers that overpay Unemployment Insurance taxes.

Unemployment Insurance Penalty and Interest

Since implementation of POINTS in December 1999, penalty and interest have not been correctly assessed to employers who are late filing reports or who do not pay UI taxes due. State law requires the department to assess a late filing penalty of $50 or the amount of the tax due, whichever is less and that interest will be accrued on any unpaid tax.

The POINTS system is automatically assessing penalties and interest to all employers because it is not matching the correct receipt date to the date the taxes are due. The department is also not able to

identify from POINTS all employers on the system who should be assessed penalties and interest as required by state law. In addition the accounting records are also misstated because the incorrect assessments caused POINTS to incorrectly allocate portions of tax payments to penalty and interest. The distinction is important because tax payments are required by federal law to be deposited in the Unemployment Insurance Expendable Trust Fund and may only be used for unemployment insurance benefits. Penalty and interest payments, on the other hand, are deposited in a Special Revenue Fund and may be used to offset the cost to administer the UI program. As a result, accounts receivable and revenue may be overstated by as much as $465,997 in the Special Revenue Fund in fiscal year 1999-00.

Department personnel were unable to identify where the portion of the tax payments allocated to penalty and interest should have been recorded. Personnel said the department is currently working on changes so POINTS will correctly assess penalties and interest.

Recommendation #5
We recommend the Department:

A. Assess penalties and interest for UI in compliance with state law.

B. Analyze activity in the Special Revenue Penalty and Interest Fund to identify and make necessary adjustments to correct the accounting records.

Deposit of UI Funds

Since the implementation of POINTS in December 1999, UI receipts have not been deposited in the U.S. Treasury cash clearing account as required by federal law. Section 3304(a)(3) of the Federal Unemployment Tax Act (FUTA) requires as a condition of employers in a state receiving credit against the federal unemployment tax, that all money received in the unemployment fund shall immediately upon such receipt be paid over to the U.S.

Secretary of the Treasury to the credit of the Unemployment Trust Fund established by section 904 of the Social Security Act.

From the time POINTS was implemented in December 1999 until February 7, 2000, UI receipts totaling $842,953 were not transferred to the U.S. clearing account as required by federal regulations. The receipts were deposited in the state treasury. The department negotiated with the federal Department of Labor and has paid approximately $8,500 for interest earned by the General Fund that the receipts would have earned in the U.S. Treasury accounts.

UI payments that department personnel cannot immediately associate with an account number are a continuing problem with POINTS. As a result some payments are not getting deposited in the U.S. Treasury accounts immediately as required by federal regulations. Department personnel have calculated and remitted interest for these funds through February 7, 2000. Another calculation and interest payment will have to be made for the time period between February 8, 2000, and the date the problem is corrected. Department personnel stated that POINTS does not have the information necessary to immediately deposit the funds in the correct accounts that are required for UI.

Noncompliance with federal UI deposit regulations could jeopardize employers' use of the state tax as a credit against the federal tax and result in the loss of administration grant funds used to administer the UI program. The department should implement procedures to ensure UI receipts are immediately deposited into the U.S. Treasury clearing account as required by federal law.

Recommendation #6
We recommend the department comply with federal law related to the immediate deposit of UI receipts in the U.S. Treasury clearing account.

Internal Service Fund

In fiscal year 1999-00, the department began using an internal service fund to account for its Customer Service Center (CSC). The CSC consists of three different processes: Document Control and Information Processing (DIP), Accounts Receivable and Collections (ARC), and Customer Intake.

Section 17-8-101(6), MCA, states: “Fees and charges for services deposited in the internal service fund type must be based upon commensurate costs. The legislative auditor, during regularly scheduled audits of state agencies, shall audit and report on the reasonableness of internal service fund type fees and charges and on the fund equity balances.”

During our audit of the department we reviewed the Internal Service Fund (ISF) operated by the department to determine compliance with state law and because department officials requested we review the ISF rate-setting process since it was a new operation for them beginning in fiscal year 1999-00. Our review included determining the reasonableness of the rates by reviewing the volume estimates and costs associated with the CSC. Based on our review, we concluded that the department’s ISF rates are not commensurate with costs as required by state law, because volume estimates were not accurate. However, the department’s overall methodology for determining the rates is reasonable.

When the department was determining the rates to charge to cover costs, it used estimated transaction volumes assuming other state agencies would use its CSC. The department went through a process to determine what other agencies could potentially benefit from using the CSC. They determined there were twelve agencies which performed functions that the CSC could perform. The department used these numbers to predict volumes, even though they did not have any commitments from the agencies to use its services. The department predicted they would be providing services to four agencies in fiscal year 2000 and an additional eight in 2001. During fiscal year 2000, and through September of fiscal year 2001, only

two outside agencies were using the CSC. Therefore, the volume the department anticipated was higher than what was actually experienced. The department was unable to cover the costs of operating the ISF.

The CSC charged the department for costs it could not cover, based on appropriated amounts. Total revenue recorded in the ISF at fiscal year-end 1999-00 was $5,959,147. Of this total, $4,170,841 was not generated by billing for actual services but by charging appropriations in the General and Enterprise Funds. Department personnel indicated they were planning on reconciling actual billings to the amounts charged once billing procedures were finalized. However, the billings procedures were not finalized until late in the fiscal year, so reconciliations were not completed. As a result, $3,974,855 of expenditures charged to the General Fund, $195,986 of expenditures charged to the Enterprise Fund, and $4,170,841 of revenue recorded in the ISF were not supported by billings for services at fiscal year-end.

At the end of fiscal year 1999-00, the department requested and received a $1.2 million inter-entity loan from the General Fund to cover the shortages. Documentation in the request for the loan states that department is expecting to payback the loan from increased services during fiscal year 2001. The ending fund balance in the ISF is a negative $751,400. As a result, we believe the department will not be able to pay back the loan by fiscal year-end 2001 through the appropriate billing of actual services at the rates established by law. Department management believes increased usage will allow them to repay the loan by fiscal year-end 2001.

Department personnel noted that they did not have accurate historical data to come up with the rates and they did not have the volume of business they had anticipated. In order to have the necessary start-up costs they charged appropriation amounts, and since the rates are set in law the department was unable to increase the rates to cover the costs. The department should continue to monitor the operating results of the fund, and adjust rates in the next

rate setting process in order to comply with the state law that requires the rates be commensurate with costs. Department personnel indicated the rates have been adjusted appropriately in the budget for fiscal years 2002 and 2003.

Recommendation #7
We recommend the department:

A. Reasonably estimate volumes when calculating ISF rates to ensure rates are commensurate with costs.

B. Charge for actual services provided to all customers using approved rates.

Unemployment Insurance Agreements

Part of the department's ISF activity is generated by providing services to the Department of Labor and Industry (DOLI) for collecting and monitoring UI taxes. The department has entered into agreements with DOLI for these services.

We tested compliance with the agreements as part of our work at the CSC. The department met or exceeded many requirements in the agreements, however, we noted some instances where the department was not in compliance with requirements in the agreements regarding billing DOLI for UI services, providing required information for federal reporting, and meeting agreement requirements related to UI audits. In addition, while reviewing the billings we found the department was not in compliance with a state law related to the use of non-General Fund money first and compliance with state policy for an expenditure accrual. These items are all discussed in the sections below.

UI Billings

The agreements require the department to bill DOLI monthly for their services. During our review of fiscal year 2000 transactions, we noted that the department only billed DOLI for UI services three times during the year, in January, April, and June. However, services provided for UI throughout the year were charged to the General Fund appropriation, as discussed on page 22.

Only when the department billed DOLI were the amounts charged to the General Fund removed. The department billed the General Fund a total of $1,801,407 for UI. Of this amount, $471,792 was removed in January and $214,484 was removed in April when UI was billed.

As a result of not billing monthly as required in the agreement, the department is not in compliance with section 17-2-108, MCA, which states, "An office or entity of the executive, legislative, or judicial branch of state government shall apply expenditures against appropriated non-general fund money whenever possible before using general fund appropriations."

In addition, while reviewing the transactions we found that $548,688 of an expenditure accrual charged to a federal program was not in compliance with state policy. As a result, we question the allowability of the charge to the federal program. The department accrued $1,115,131 for the services provided to DOLI from December 1999 to June 2000 in the federal Special Revenue Fund. However $548,688 of the accrual was not valid because the work was not completed by June 30,2000, and was not supported by billings to DOLI. Department personnel stated they could not bill DOLI for the $548,688 because UI audits were not complete because they were not entered on a computer system as required by federal regulations. Since the service was not in a complete enough matter to be billed by June 30, 2000, it should not have been accrued on the accounting records as a service that was completed by June 30, 2000.

Reporting

The work agreement requires the department to provide information on unemployment insurance premium collections and accounts receivable to the DOLI by the 15th of the month following each quarter. DOLI is responsible for preparing the ETA 581 using this information and submission to the U.S. Department of Labor. We found that the department was unable to provide this information to DOLI for the quarters ended March 31 and June 30, 2000, as required by the cooperative agreement. As a result, DOLI has been unable to submit the report and has been placed on a continuous improvement plan to correct the reporting deficiency. Department personnel indicated they have been unable to obtain the necessary information from the POINTS system to prepare the reports but the problem is being addressed.

Employer Audits

As part of the agreement, the department's Compliance, Valuation and Resolution (CVR) division performs employer audits for UI. The department has not billed DOLI since November 1999 for any of the audits they have performed. The department performed 307 audits from December 1999 to July 2000. The department did not bill for these audits because they were unable to input the audit information into the new POINTS system. As a result of not being able to input the audit information into POINTS, the department has not received approximately $158,000 of revenue for these audits and the accounting records have not been updated for any necessary adjustments resulting from the audits.

Number of Required Audits

The agreement with DOLI includes three criteria, that exceed the federal requirements, for the number of UI audits to be completed. The criteria requires the department to obtain at least a 5 percent change in total wages from adjustments resulting from audit. It also requires 2.5 percent of contributing employers to be audited by December 31, 1999, and a minimum of 1.8 percent of total wages must be audited. Based on the department's calculations, they were not in compliance with the agreement; however, they did meet federal requirements. The department audited 4.6 percent of changes in total wages, 2.0 percent of contributory employers by December 21, 1999, and 1.5 percent of total wages.

The department has been working on improving its billing system to improve its accuracy. Department personnel said they have tried to bill DOLI on a regular basis, but DOLI would not pay the bills because of the lack of support for the amounts. The department should comply with the provisions of the agreements with DOLI, and comply with state law and accounting policy regarding the use of non-General Fund fund money first and expenditure accruals.

Recommendation #8
We recommend the department:

A. Comply with its UI tax collection, reporting, and monitoring agreements with the DOLI.

B. Comply with state law regarding spending non-general fund money first.

C. Comply with state policy related to expenditure accruals.

Revenues Collected by the Department of Revenue for Other State Agencies

State law requires the Department of Revenue to collect a variety of revenues on behalf of the state of Montana. The department records these revenues on its accounting records regardless of whether it administers the benefiting state or federal program. Some examples include the statewide mill levies used by the Office of Public Instruction to pay the state's share of K-12 school funding; the universal access revenues used by Public Service Regulation; cigarette taxes used by the Department of Public Health & Human Services and the Long Range Building Program administered by the Department of Administration's Architecture and Engineering Division; and Resource Indemnity Trust investment earnings used by the Department of Environmental Quality. The department has also entered into inter-agency agreements to act as the collection agent for programs administered by other state agencies, e.g., unemployment insurance contributions and some business licenses collected as part of the department's one-stop licensing program.

There are three primary methodologies used by the department for recording revenue transactions on behalf of other state agencies.

1. Record the revenue to the credit of the Department of Revenue with no further action on the department's part. This method is used for most of the tax collections, as well as moneys collected through tax check-off programs.

   Fiscal year 1999-00 revenues collected on behalf of other agencies and recorded by the department on its records totaled over $272 million. Page 28 details these revenues by state agency.

Revenues Collected by the Department of Revenue for Other State Agencies

State Agency	Amount
Administration	$ 9,161,587
Agriculture	6,039
Arts Council	166,259
Commissioner of Higher Education	14,274,613
Commerce	13,880,304
Consumer Counsel	949,096
Environmental Quality	2,776,656
Fish, Wildlife & Parks	1,240,582
Governor's Office	175,000
Historical Society	505,138
Labor & Industry	6,380,669
Natural Resources & Conservation	10,542,266
Office of Public Instruction	192,685,054
Public Health & Human Services	12,914,036
Public Service Regulation	2,440,553
Revenue	2,277,255
State Fund	1,892,209
Total	$ 272,267,316

Source: Compiled by the Legislative Audit Division from Department accounting records.

2. Record the revenue to the credit of the Department of Revenue throughout the fiscal year and allow the administering agency to move the revenue to its records during the fiscal year-end cutoff period. This method is used for unemployment insurance taxes.

   Unemployment Insurance Contributions collected by the department and recorded on its records during fiscal year 1999-00 exceeded $60 million. The Department of Labor & Industry processed transactions to move this revenue from the Department of Revenue's accounting records to its own accounting records during the fiscal year-end period.

3. Record the revenue transactions at the Department of Revenue in an agency fund and subsequently reduce the agency fund and revenues and record them to the credit of the administering agencies. This method is used in the one-stop licensing program.

   The revenues collected and distributed by the department's One-Stop Licensing Program during fiscal year 1999-00 totaled nearly $1.5 million.

The method used is dependent on whether the administering agency has requested the department to collect revenues on its behalf or whether the department has historically collected the revenues. The result is inconsistent accounting treatment for similar transactions.

Recording revenue directly on the administering agencies' accounting records would facilitate the agencies' compliance with state law that requires all state agencies to input all necessary transactions to the accounting system in order to present the receipt, use, and disposition of all money and property for which the agency is accountable in accordance with generally accepted accounting principles. These agencies would also have more efficient access to complete accounting information. Additionally, there should be fewer transactions needed during the fiscal year-end cut-off period, as the need to process transfers of cash to or from the administering agencies, as is currently done, would no longer be required. We believe the department should work on this issue with the Department of Administration which is responsible for establishing state accounting policy.

This section is presented for disclosure purposes to allow the department and the Legislature an opportunity to consider this issue. We make no recommendation at this time.

Independent Auditor's Report & Department Financial Schedules

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel
Tori Hunthausen, IT & Operations Manager

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Revenue for each of the fiscal years ended June 30, 1999 and 2000. The information contained in these financial schedules is the responsibility of the department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than generally accepted accounting principles. The schedules are not intended to be a complete presentation and disclosure of the department's assets, liabilities, and cash flows.

The department did not correctly distribute investment income as required by state law. Consequently, on the Schedule of Total Revenues & Transfer-In for fiscal year 1999-00 General Fund and Special Revenue Fund Other Financing Sources are overstated by $27,161,876 and $6,067,815, respectively. On the Schedule of Total Expenditures and Transfer-Out for fiscal year 1999-00 Accounting Entity Transfers are overstated by $33,229,691.

The department did not record all U.S. mineral royalty revenue received during fiscal year 1999-00 on the accounting records. As a result General Fund Taxes revenue on the Schedule of Total Revenue and Transfers-In for fiscal year 1999-00 is understated by $3,275,549.

In our opinion, except for the effects of not properly distributing investment income and not recording all U.S. mineral royalty receipts as described in the preceding paragraphs, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund

balances/property held in trust of the Department of Revenue for the two fiscal years ended June 30, 1999 and 2000, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

(Signature on File)

James Gillett, CPA
Deputy Legislative Auditor

September 15, 2000

DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2000

	General Fund	Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Expendable Trust Fund	Nonexpendable Trust Fund
FUND BALANCE: July 1, 1999	$ (16,592,302)	$ 11,518,791	$ 224,577	$ 10,358,422	$ 3,348,466	$ 0	$ 0	$ 1,524,079	$ 599,247,459
PROPERTY HELD IN TRUST: July 1, 1999							$ 5,202,415		
ADDITIONS									
Budgeted Revenues & Transfers-In	964,249,491	93,846,312	279,963	23,641,436	49,148,561	6,339,079		381,283	44,975,055
NonBudgeted Revenues & Transfers-In	9,257,055	17,425,801		506	7,230,522	87	(297,605)	21,954	18,368,838
Prior Year Revenues & Transfers-In Adjustments	(10,572,011)	(933,903)	(50,173)	(267,587)			297,605		(1,138,978)
Cash Transfers In(Out)									
Direct Entries to Fund Balance	(895,246,451)	(60,511,328)	(437,729)	(6,099,923)	(3,035,993)	557,918	(1,663)	(64,436)	118,064,890
Additions To Property Held in Trust							17,374,028		
Total Additions	67,688,084	49,826,882	(207,939)	17,274,432	53,343,090	6,897,084	17,372,365	338,801	180,269,805
REDUCTIONS									
Budgeted Expenditure & Transfers-Out	51,540,757	47,249,760		9,782,216	52,896,452	7,154,400			
NonBudgeted Expenditure & Transfers-Out	7,231	2,832,225			214,384	494,084		2,973	79,942,351
Prior Year Expenditure & Transfers-Out Adjustments	(8,937)	(670,828)			(72,856)				
Reductions in Property Held in Trust							11,787,449		
Total Reductions	51,539,051	49,411,157		9,782,216	53,037,980	7,648,484	11,787,449	2,973	79,942,351
FUND BALANCE: June 30, 2000	$ (443,269)	$ 11,934,516	$ 16,638	$ 17,850,638	$ 3,653,576	$ (751,400)	$ (1,663)	$ 1,859,907	$ 699,574,913
PROPERTY HELD IN TRUST: June 30, 2000							$ 10,788,994		

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 1999

	General Fund	Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Agency Fund	Expendable Trust Fund	Nonexpendable Trust Fund
FUND BALANCE: July 1, 1998	$ (12,182,400)	$ 8,740,150	$ 168,530	$ 15,468,723	$ 5,421,961	$ 0	$ 58,452,125	$ 626,020,128
PROPERTY HELD IN TRUST: July 1, 1998						$ 344,636		
ADDITIONS								
Budgeted Revenues & Transfers-In	893,744,275	100,247,899	827,268	6,326,668	78,898,276		262,368	39,287,658
Nonbudgeted Revenues & Transfers-In	(2,983,782)	1,012,674		634,911	(106,383)		16,210	16,749,471
Prior Year Revenues & Transfers-In Adjustments	17,817,671	4,366,798	20,930	111,627	5,408			502,815
Cash Transfers In (Out)	(885,241,827)	(62,161,186)	(792,151)	(6,162,118)	(31,214,977)			(4,493,506)
Direct Entries to Fund Balance	10,107,731	4,960,411			74,803		(57,180,439)	(14,483,059)
Additions to Property Held in Trust						5,202,415		
Total Additions	33,444,068	48,426,596	56,047	911,088	47,657,127	5,202,415	(56,901,861)	37,563,379
REDUCTIONS								
Budgeted Expenditures & Transfers-Out	37,876,244	42,088,279		6,021,389	50,024,798			
Nonbudgeted Expenditures & Transfers-Out		2,272,628			(385,534)		26,185	42,724,684
Prior Year Expenditures & Transfers-Out Adjustments	(22,274)	1,287,048			91,358			21,611,364
Reductions to Property Held in Trust						344,636		
Total Reductions	37,853,970	45,647,955	0	6,021,389	49,730,622	344,636	26,185	64,336,048
FUND BALANCE: June 30, 1999	$ (16,592,302)	$ 11,518,791	$ 224,577	$ 10,358,422	$ 3,348,466	$ 0	$ 1,524,079	$ 599,247,459
PROPERTY HELD IN TRUST: June 30, 1999						$ 5,202,415		

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2000

TOTAL REVENUES & TRANSFERS-IN BY CLASS	General Fund	Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Expendable Trust Fund	Nonexpendable Fund	Total
Licenses and Permits	$ 6,396,076	$ 349,391			$ 1,700,749					$ 8,446,216
Taxes	874,288,764	80,338,808	$ 229,790	$ 5,105,468	13,745,306	$ 87			$ 17,536,807	991,245,030
Charges for Services	161,898	4,980,215			5,761	6,339,079				11,486,953
Investment Earnings		86,662		268,887			$ 0	$ 0	27,105,302	27,460,851
Fines and Forfeits		334,817			92,091					426,908
Federal Indirect Cost Recovery	11,202									11,202
Sale of Documents, Merchandise and Property					40,793,593					40,793,593
Rentals, Leases and Royalties										0
Contributions and Premiums		5,198,572						381,283		5,579,855
Miscellaneous	162,170	466,189			41,583		0			669,942
Grants, Contracts, Donations and Abandonments	1,880,962	134,142						21,954		2,037,058
Other Financing Sources	66,695,386	18,162,635		18,000,000					17,562,806	120,420,827
Federal	13,338,077	286,779								13,624,856
Total Revenues & Transfers-In	962,934,535	110,338,210	229,790	23,374,355	56,379,083	6,339,166	0	403,237	62,204,915	1,222,203,291
Less: Nonbudgeted Revenues & Transfers-In Adjustments	9,257,055	17,425,801	0	506	7,230,522	87	(297,605)	21,954	18,368,838	52,007,158
Prior Year Revenues & Transfers-In Adjustments	(10,572,011)	(933,903)	(50,173)	(267,587)	0	0	297,605	0	(1,138,978)	(12,665,047)
Actual Budgeted Revenues & Transfers-In	964,249,491	93,846,312	279,963	23,641,436	49,148,561	6,339,079	0	381,283	44,975,055	1,182,861,180
Estimated Revenues & Transfers-In	936,833,243	121,274,666	282,000	4,196,007	53,877,500	12,163,763	0	60,000,000	61,576,403	1,250,203,582
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ 27,416,248	$ (27,428,354)	$ (2,037)	$ 19,445,429	$ (4,728,939)	$ (5,824,684)	$ 0	$ (59,618,717)	$ (16,601,348)	$ (67,342,402)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS										
Licences and Permits	$ 187,257	$ 163,873			$ 175,749					$ 526,879
Taxes	23,039,372	(30,355,931)	$ (2,037)	$ 1,737,055	488,291				$ 10,748,813	5,655,563
Charges for Services	(120,070)	603,638			760	$ (5,824,684)				(5,340,356)
Investment Earnings		(87,349)		(291,622)					(27,350,161)	(27,729,132)
Fines and Forfeits	(100)	(19,183)			17,091					(2,192)
Federal Indirect Cost Recovery	(15,000)									(15,000)
Sale of Documents, Merchandise and Property	(1,000)				(5,395,330)					(5,396,330)
Rentals, Leases and Royalties					(500)					(500)
Contributions and Premiums		798,572						$ (59,618,717)		(58,820,145)
Miscellaneous	(2,100)	111,997			(15,000)					94,897
Grants, Contracts, Donations and Abandonments	320,893	3,186								324,079
Other Financial Sources	8,198,451	3,096,135		17,999,996						29,294,582
Federal	(4,191,455)	(1,743,292)					$			(5,934,747)
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ 27,416,248	$ (27,428,354)	$ (2,037)	$ 19,445,429	$ (4,728,939)	$ (5,824,684)	$ 0	$ (59,618,717)	$ (16,601,348)	$ (67,342,402)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 1999

	General Fund	Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Agency Fund	Expendable Trust Fund	Nonexpendable Trust Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS									
Licenses and Permits	$ 5,783,348	$ 660,042			$ 1,760,031				$ 8,203,421
Taxes	831,174,151	76,603,740	$ 848,198	$ 6,438,294	39,913,337	$ (184,172)		$ 20,228,263	975,021,811
Charges for Services	292,783	4,495,476			5,115				4,793,374
Investment Earnings		5,327		634,912		184,172		19,562,210	20,386,621
Fines and Forfeits	1,500	648,564			82,118				732,182
Federal Indirect Cost Recoveries	12,533								12,533
Sale of Documents, Merchandise and Property					36,993,703				36,993,703
Contributions and Premiums		4,451,451					$ 262,368		4,713,819
Miscellaneous	47,264	28			42,997				90,289
Grants, Contracts, Donations and Abandonments	1,254,744	115,225					16,210		1,386,179
Other Financing Sources	52,595,776	15,657,980						16,749,471	85,003,227
Federal	17,416,065	2,989,538							20,405,603
Total Revenues & Transfers-In	908,578,164	105,627,371	848,198	7,073,206	78,797,301	0	278,578	56,539,944	1,157,742,762
Less: Nonbudgeted Revenues & Transfers-In	(2,983,782)	1,012,674		634,911	(106,383)		16,210	16,749,471	15,323,101
Prior Year Revenues & Transfers-In Adjustments	17,817,671	4,366,798	20,930	111,627	5,408			502,815	22,825,249
Actual Budgeted Revenues & Transfers-In	893,744,275	100,247,899	827,268	6,326,668	78,898,276	0	262,368	39,287,658	1,119,594,412
Estimated Revenues & Transfers-In	855,190,169	113,876,313	810,000	6,250,000	102,803,206		58,000,000	71,779,806	1,208,709,494
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ 38,554,106	$ (13,628,414)	$ 17,268	$ 76,668	$ (23,904,930)	$ 0	$ (57,737,632)	$ (32,492,148)	$ (89,115,082)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS									
Licenses and Permits	$ (553,207)	$ 260,041			$ (575,214)				$ (868,380)
Taxes	68,898,653	(14,117,104)	$ 17,268	$ 76,668	(21,240,157)			$ 145,648	33,780,976
Charges for Services	19,561	520,029			(1,885)				537,705
Investment Earnings		(81,670)						(32,637,796)	(32,719,466)
Fines and Forfeits	(100)	248,564			42,118				290,582
Federal Indirect Cost Recoveries									0
Sale of Documents, Merchandise and Property	(1,000)				(2,129,792)				(2,130,792)
Contributions and Premiums		51,451					$ (57,737,632)		(57,686,181)
Miscellaneous									0
Grants, Contracts, Donations and Abandonments	171,344	(8,278)							163,066
Other Financing Sources	(26,151,460)	(2,160,212)							(28,311,672)
Federal	(3,829,685)	1,658,765							(2,170,920)
Budgeted Revenues & Transfers-In Over (under) Estimated	$ 38,554,106	$ (13,628,414)	$ 17,268	$ 76,668	$ (23,904,930)	$ 0	$ (57,737,632)	$ (32,492,148)	$ (89,115,082)

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2000

	Programs (Sub-Class) Not Specified	Director's Office	Information Technology	Resource Mgmt.	Customer Service Info. Proc.	Compliance Valuation Resolution	Total
PROGRAM (SUB-CLASS) EXPENDITURES & TRANSFERS-OUT							
PERSONAL SERVICES							
SALARIES		$ 1,541,327	$ 1,346,060	$ 1,171,541	$ 3,118,469	$ 10,536,763	$ 17,714,160
EMPLOYEE BENEFITS		361,815	326,479	310,459	883,862	2,983,808	4,866,423
PERSONAL SERVICES-OTHER	$ 422,755						422,755
Total	422,755	1,903,142	1,672,539	1,482,000	4,002,331	13,520,571	23,003,338
Operating Expenses							
Other Services		10,388,190	428,281	597,609	1,266,311	5,843,171	18,523,562
Supplies & Materials		104,519	143,553	153,623	171,522	791,796	1,365,013
COMMUNICATIONS		31,040	37,454	54,357	356,019	826,799	1,305,669
TRAVEL		40,531	9,268	23,695	36,890	464,112	574,496
Rent		31,702	51,717	62,700	115,595	692,408	954,122
UTILITIES				40,967	431	7,632	49,030
REPAIR & MAINTENANCE		22,839	22,982	40,721	99,293	111,802	297,637
OTHER EXPENSES	249,406	55,936	35,102	110,709	129,610	273,845	854,608
GOODS PURCHASED FOR RESALE				32,181,988			32,181,988
Total	249,406	10,674,757	728,357	33,266,369	2,175,671	9,011,565	56,106,125
Equipment & Intangible Assets							
Equipment	(90,827)	38,288		(47,709)		11,202	(89,046)
INTANGIBLE ASSETS				3,300	3,300	4,400	11,000
INSTALLMNT PURCHASES-EQUIP-NB	7,231						7,231
Total	(83,596)	38,288		(44,409)	3,300	15,602	(70,815)
LOCAL ASSISTANCE							
FROM STATE SOURCES				4,319,547		65,327,427	69,646,974
Total				4,319,547	0	65,327,427	69,646,974
TRANSFERS							
ACCOUNTING ENTITY TRANSFERS	82,777,548			19,547,998	345,756		102,671,302
Total	82,777,548			19,547,998	345,756		102,671,302
Debt Service							
BONDS				455	455	606	1,516
INSTALLMENT PURCHASES						5,772	5,772
Total				455	455	6,378	7,288
Total Expenditures & Transfers-Out	$ 83,366,113	$ 12,616,187	$ 2,400,896	$ 58,571,960	$ 6,527,513	$ 87,881,543	$ 251,364,212
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	$ 7,231	$ 2,630,237	$ 1,899,467	$ 1,167,135	$ (593)	$ 45,835,574	$ 51,539,051
Special Revenue Fund	2,832,225	64,061	178,339	4,319,547	(28,984)	42,045,969	49,411,157
Capital Projects Fund		9,782,216					9,782,216
Enterprise Fund	153,798			52,884,182			53,037,980
Internal Service Fund	427,536	139,673	323,090	201,096	6,557,090		7,648,485
Expendable Trust Fund	2,973						2,973
Nonexpendable Trust Fund	79,942,350						79,942,350
Total Expenditures & Transfers-Out	83,366,113	12,616,187	2,400,896	58,571,960	6,527,513	87,881,543	251,364,212
Less: Nonbudgeted Expenditures & Transfers-Out	83,366,113	0	0	60,586	66,549	0	83,493,248
Prior Year Expenditures & Transfers-Out Adjustments	0	53,183	0	(49,763)	(29,577)	(726,463)	(752,620)
Actual Budgeted Expenditures & Transfers-Out	0	12,563,004	2,400,896	58,561,137	6,490,541	88,608,006	168,623,584
Budget Authority	0	29,014,013	2,406,294	60,511,332	6,670,382	100,555,418	199,157,439
Unspent Budget Authority	$ 0	$ 16,451,009	$ 5,398	$ 1,950,195	$ 179,841	$ 11,947,412	$ 30,533,855
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund		$ 57,963	$ 2,591	$ 2,559		$ 3,970,989	$ 4,034,102
Special Revenue Fund		2,910	2,807	61,043		7,976,422	8,043,182
Capital Projects Fund		16,390,136					16,390,136
Enterprise Fund				1,886,593			1,886,593
Internal Service Fund			0		$ 179,841		179,841
Expendable Trust Fund							0
Nonexpendable Trust Fund	$						0
Unspent Budget Authority	$ 0	$ 16,451,009	$ 5,398	$ 1,950,195	$ 179,841	$ 11,947,411	$ 30,533,854

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 1999

	Directors Office	Information Technology	Resource Management	Customer Service & Infor Proc	Compliance Valuation & Resol.	Total
EXPENDITURES & TRANSFERS-OUT BY OBJECT						
Personal Services						
Salaries	$ 1,958,677	$ 897,042	$ 1,102,466	$ 2,202,775	9,909,946	$ 16,070,906
Other Compensation	250					250
Employee Benefits	333,403	286,666	305,800	630,845	2,895,104	4,451,818
Personal Services-Other			13,461			13,461
Total	2,292,330	1,183,708	1,421,727	2,833,620	12,805,050	20,536,435
Operating Expenses						
Other Services	6,423,388	305,241	118,574	1,430,792	1,135,836	9,413,831
Supplies & Materials	130,746	30,823	82,544	337,741	464,425	1,046,279
Communications	30,777	22,784	51,440	418,151	354,607	877,759
Travel	41,851	10,624	11,745	15,493	311,876	391,589
Rent	209,715	26,023	27,084	95,044	460,234	818,100
Utilities			44,227		885	45,112
Repair & Maintenance	24,774	11,910	65,186	42,606	125,957	270,433
Other Expenses	29,717	50,576	(207,707)	658,699	766,627	1,297,912
Goods Purchased For Resale			30,202,310			30,202,310
Total	6,890,968	457,981	30,395,403	2,998,526	3,620,447	44,363,325
Equipment & Intangible Assets						
Equipment	18,776	9,098	(1,472)	25,832	117,666	169,900
Intangible Assets	117,192	11,963		160,000		289,155
Total	135,968	21,061	(1,472)	185,832	117,666	459,055
Capital Outlay						
Buildings			(31,405)			(31,405)
Total			(31,405)			(31,405)
Local Assistance						
From State Sources			4,060,687		48,713,178	52,773,865
Total			4,060,687		48,713,178	52,773,865
Benefits & Claims						
From State Sources					209	209
Total					209	209
Transfers						
Accounting Entity Transfers			65,729,317	26,185	19,751,452	85,506,954
Total			65,729,317	26,185	19,751,452	85,506,954
Debt Service						
Installment Purchases	2,320				5,411	7,731
Total	2,320				5,411	7,731
Total Expenditures & Transfers-Out	$ 9,321,586	$ 1,662,750	$ 101,574,257	$ 6,044,163	$ 85,013,413	$ 203,616,169
EXPENDITURES & TRANSFERS-OUT BY FUND						
General Fund	$ 2,874,439	$ 1,655,278	$ 925,724	$ 4,209,213	28,189,316	$ 37,853,970
Special Revenue Fund	425,758	7,472	4,060,687	1,808,765	39,345,273	45,647,955
Capital Projects Fund	6,021,389					6,021,389
Enterprise Fund			49,730,622			49,730,622
Expendable Trust Fund				26,185		26,185
Nonexpendable Trust Fund			46,857,224		17,478,824	64,336,048
Total Expenditures & Transfers-Out	9,321,586	1,662,750	101,574,257	6,044,163	85,013,413	203,616,169
Less: Nonbudgeted Expenditures & Transfers-Out			24,860,326	26,185	19,751,452	44,637,963
Prior Year Expenditures & Transfers-Out Adjustments	(39,270)	(7,737)	21,730,821	(2,842)	1,286,524	22,967,496
Actual Budgeted Expenditures & Transfers-Out	9,360,856	1,670,487	54,983,110	6,020,820	63,975,437	136,010,710
Budget Authority	17,588,517	1,703,223	55,442,826	6,129,780	83,026,325	163,890,671
Unspent Budget Authority	$ 8,227,661	$ 32,736	$ 459,716	$ 108,960	$ 19,050,888	$ 27,879,961
UNSPENT BUDGET AUTHORITY BY FUND						
General Fund	$ 1,279	$ 2,082	$ 3,844	$ 765	83,899	$ 91,869
Special Revenue Fund	54,031	30,654	35,444	108,195	18,966,989	19,195,313
Capital Projects Fund	8,172,351					8,172,351
Enterprise Fund			420,428			420,428
Unspent Budget Authority	$ 8,227,661	$ 32,736	$ 459,716	$ 108,960	$ 19,050,888	$ 27,879,961

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-11.

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 2000

Summary of Significant Accounting Policies

1. Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental, Expendable Trust, and Agency Funds. In applying the modified accrual basis, the department records:

> Revenues when it receives cash or when receipts are measurable and available to pay current period liabilities.
>
> Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual leave and sick leave when used or paid.

The department uses accrual basis accounting for its Proprietary and Nonexpendable Trust Funds. Under the accrual basis, as defined by state accounting policy, the department records revenues in the accounting period earned when measurable and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

Accounts are organized in funds according to state law. The department uses the following funds:

Notes to the Financial Schedules

Governmental Funds	**General Fund** - to account for all financial resources except those required to be accounted for in another fund.
	Special Revenue Fund - to account for proceeds of specific revenue sources legally restricted to expenditures for specific purposes. Department Special Revenue Funds include distributions of the following revenue types: Corporation Tax-Financial Institution, Oil & Gas Production Tax, Coal Tax, and Alcohol Tax. The Special Revenue Funds are also used to account for moneys the department collects on behalf of other state agencies through the use of shared accounts such as Accommodations Tax and University Millage.
	Debt Service Fund - to account for accumulated resources for the payment of General Long-term Debt Principal and Interest. The department uses this fund for the Long Range Building Program and the Renewable Resource Bond Funds.
	Capital Projects Fund - to account for resources used for purchase or construction of major capital facilities. The department uses this fund for the Long Range Building Program and funding for POINTS system.
Proprietary Funds	**Enterprise Fund -** to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that the department finance or recover costs primarily through user charges; or (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate. Department Enterprise Funds include the liquor division and the old fund liability tax collections.
	Internal Service Fund- to account for providing goods or services on a cost-reimbursement basis. The department's Internal Service Fund is the Customer Service Center.
Fiduciary Funds	**Trust Funds -** to account for assets held by the State in a trustee capacity or as an agent for individuals, private organizations, other

governments or other funds. The department's Expendable Trust Funds are used to account for unclaimed and escheat property and the Unemployment Insurance Program. The department's Nonexpendable Trust Funds include the Permanent Coal Trust Fund, The Cultural Trust, the Coal Severance Tax Income and Bond Funds, the Resource Indemnity Trust Fund, the Common School Trust Fund, and the Treasure State Endowment and Income Funds.

Agency Funds - to account for assets held by the State as an agent for individuals, private organizations, other governments or other funds. The department uses the agency funds as a clearing account to facilitate the distribution of gas and oil taxes.

2. General Fund Balance

The negative fund balance in the General Fund does not indicate overspent appropriation authority. Each agency does not have a separate General Fund since its only authority is to pay obligations from the statewide General Fund within its appropriation limits. Each agency records cash or other assets from the statewide fund when it pays General Fund obligations. The department's outstanding liabilities exceed the assets the agency has placed in the fund, resulting in negative ending General Fund balances at June 30, 1999, and June 30, 2000.

3. Expenditure Program (Sub-class)

As part of the implementation of a new accounting system in fiscal year 1999-00, state officials determined that a sub-class designation would identify the program to which expenditure should be charged. State officials did not require nonbudgeted expenditure transactions to be identified to a sub-class. The program designations in the Schedule of Total Expenditures & Transfers-Out for the fiscal year ended June 30, 2000, are based on the sub-class designation used when the expenditures were recorded. The accounting system did not require agencies to code nonbudgeted accounts with a sub-class code identifying the expenditure program in which the activity occurred. This nonbudgeted activity is included in the column titled program (sub-class) not identified on the Schedule of Total

Expenditures & Transfers-Out For the Fiscal Year Ended June 30, 2000.

Of the $82,777,548 in Accounting Entity Transfers included in the column discussed above, $62,188,737 relates to the Resource Management program and $20,588,811 relates to the Compliance, Valuation, and Resolution program.

4. Direct Entries to Fund Balance - Fiscal Year 1998-99

The department's direct entries on the Schedule of Changes in Fund Balance and Property Held in Trust for fiscal year 1998-99 were as follows:

Fund	Amount
General	$10,107,731
Special Revenue	4,960,411
Enterprise	74,803
Expendable Trust	(57,180,439)
Nonexpendable Trust	(14,483,059)

The department implemented Governmental Accounting Standards Board Statement #31 during fiscal year 1997-98. This standard requires the department to recognize as income (or negative income) unrealized market gains and losses on the financial records. The department recorded unrealized market gains on investments for the Coal Tax, Resource Indemnity, and Treasure State Endowment Funds during fiscal year 1997-98. The department recorded the distribution of those unrealized market gains on the accounting records in fiscal year 1998-99, as direct entries to fund balances. This accounts for the direct entries to fund balance recorded in the General, Special Revenue, and Nonexpendable Trust Funds.

Effective July 1, 1997, the unemployment insurance tax administration function moved from the Department of Labor and Industry to the Department of Revenue. The prior audit identified accounting errors which misstated the ending fund balance in the Expendable Trust Fund. The direct entries to fund balance in the Expendable Trust Fund represent the correction of those errors.

5. Cash Transfers

The Department of Revenue collects revenue for accounts administered by other state agencies. In fiscal year 1998-99 to move the cash collected to the administering, or spending agency, and to prevent recording revenues and expenditures twice, a cash transfer out is recorded on the department's records and a cash transfer in is recorded on the administering agency's records. Examples of cash transfers for both fiscal year 1998-99 and 1999-00 include statutory transfers of the accommodations tax, 9-1-1 emergency phone program, employment security account, cigarette tax, treasure state endowment, public service commission, university millage, reclamation and development, and the General Fund. In fiscal year 1999-00 similar types of transactions are included as direct entries to fund balance as discussed in note 6.

6. Direct Entries to Fund Balance - Fiscal Year 1999-00

In fiscal year 1999-00 both types of transactions described above are included as direct entries to fund balance. See below for cash transfer activity by fund that is included in direct entries in fiscal year 1999-00:

Fund	Cash Transfers
General	$ (895,198,001)
Special Revenue	(60,511,328)
Debt Service	(437,729)
Capitol Project	(6,099,923)
Enterprise	(3,019,385)
Agency	(1,663)
Nonexpendable Trust	(665,015)

7. Gain Contingencies

Certain natural resource and corporation tax assessments are not reported on the department's financial schedules because they are being protested administratively. As of June 30, 2000, the following assessments (by fund type) were outstanding (in thousands):

Taxes	General	Special Revenue	Nonexpendable Trust
Corporation	$ 4,285,991		
Metal Mines	9,851	$ 7,134	
Oil and Gas	8,563,249	513,537	
Resource Indemnity		463,218	$ 393,008
Totals	$ 12,859,091	$ 983,889	$ 393,008

Collectibility of these amounts is dependent upon the decisions of the court, other authorities, or agreed upon settlements. Interest related to corporation tax assessments is distributed 100 percent to the General Fund.

8. Unemployment Insurance

Effective July 1, 1997, the unemployment insurance tax administration function moved from the Department of Labor and Industry to the Department of Revenue. The department records the collections in the Expendable Trust Fund. In both fiscal year 1998-99 and 1999-00 the department collected approximately $60 million of unemployment insurance tax revenue. Of the $60 million, all but $262,369 in fiscal year 1998-99 and $381,283 in 1999-00 was removed from the Department's records by the Department of Labor and Industry. As a result, budgeted contribution and premium revenues are under the estimate by $57,737,632 and $59,618,717 in fiscal years 1998-99 and 1999-00, respectively on the Schedules of Total Revenue and Transfers-In.

9. Old Fund Liability Tax

On September 16, 1998, the State Fund Board of Directors recommended to the Budget Director that the Old Fund Liability Tax end on December 31, 1998. Subsequently, the Budget Director in compliance with section 39-71-2505(7), MCA, communicated to the department director that collection of the Old Fund Liability Tax could cease effective December 31, 1998. Collections of this tax in fiscal year 1998-99 were approximately $28 million.

10. Investment Earnings

On the schedules of Total Revenues and Transfers-In for the fiscal years ended June 30, 1999 and June 30, 2000, the investment earnings were under the estimate significantly due to the recording of unrealized market losses on investments in accordance with Governmental Accounting Standards Board Statement #31. The amounts under the estimate were $32,637,796 in fiscal year 1998-99 and $27,350,101 in fiscal year 1999-00.

11. Taxes - Collections Over (Under) Estimate

In fiscal years 1998-99 and 1999-00, General Fund tax revenues were in excess of estimates of $68.8 million and $23 million, respectively. The primary reason for collections over the estimated amounts relate to an increase in personal income tax collections. In fiscal years 1998-99 and 1999-00, the Special Revenue Fund tax collections were less than estimated by $17.7 million and $30.3 million, respectively. These collections were under the estimate because of lower oil & gas production tax collections caused by reduced production. The collections were under estimates in the Enterprise Fund for fiscal year 1998-99 because of the elimination of the Old Fund Liability Tax on December 31, 1998.

12. Unspent Budget Authority

On the Schedule of Total Expenditures & Transfers-Out for fiscal year 1998-99, the Director's Office program has unspent budget authority of $8,172,351 in the General Fund while the Compliance, Valuation & Resolution program has unspent authority of $18,966,989 in the Special Revenue Fund. The unspent authority in the Director's Office program relates primarily to unspent authority related to developing a new computer system and implementing a new revenue processing center. The unspent authority in the Special Revenue Fund relates primarily to reduced oil & gas production tax collections during fiscal year 1998-99 which reduced the amount of production tax distributions made to local governments by the department. The $16,390,136 of unspent budget authority in the Capital Projects Fund in fiscal year 1999-00 relates to a computer system development project.

13. Nonbudgeted Activity

The majority of the nonbudgeted revenues & transfers-in and nonbudgeted expenditures & transfers-out in the Nonexpendable Trust Fund in both fiscal years 1998-99 and 1999-00 are related to coal tax transfers made in accordance with state law.

Department Response

DEC 5 2000

Montana Department of
REVENUE

Director's Office
Sam W. Mitchell Building

P. O. Box 5805
Helena, Montana 59604-5805

December 4, 2000

Scott Seacat, Legislative Auditor
Legislative Audit Division
Room 135, State Capitol
P.O. Box 201705
Helena, MT 59620-1705

Dear Scott:

Thank you for the opportunity to provide a response to the audit recommendations contained in your Financial Compliance audit report. We have carefully reviewed the report and its recommendations and provide the following comments.

Recommendation #1 – We recommend the department establish controls to properly account for coal tax income distributions, record UI expenditures, and estimate revenue accruals to ensure compliance with state law and accounting policy.

Partially Concur. We agree the department should demonstrate compliance with state law and accounting policy. We also agree there is a need to review accounting transactions in a timely manner to correct identified errors prior to the close of fiscal year-end. The department believes we are, and have been, in compliance with state law and accounting policy. The department has spent considerable time in improving its control structure; however, we recognize we need continue to implement and communicate our control and monitoring procedures to ensure we remain in compliance with state law and accounting policy. The department has implemented business processes designed to improve efficiency and has instituted numerous changes to ensure control procedures are in place. These changes include initiating a department-wide performance appraisal process, re-writing and reviewing role descriptions with all employees, establishing department policies and procedures, implementing a team approach among work units and cross-training employees.

We do not believe your report establishes a basis to suggest the department could continue to have similar types of errors in the future. The review and control procedures in place within the department allowed department staff to identify the majority of the errors included in this report, which allowed us to subsequently correct the errors.

We partially agree with the issue raised regarding recording UI expenditures. We concur expenditures should be properly classified. However, since we are billing for

services provided and not for the expenses we have incurred, we are in compliance with state accounting policy and expenses are classified properly. This method is in compliance with the "Fee-For-Service Proposal" we have entered into with DOLI for the services we provide.

It is true at fiscal year-end the department experienced turnover. The person who had previously recorded these entries in prior years, and who also supervised the accounting unit, left the department prior to fiscal year-end. This required personnel who had not previously been involved in these types of fiscal year-end activities to learn the transactions and make the journal entries. Unfortunately, some entries were made incorrectly; however, the accounting staff has learned from this experience and we do not anticipate such errors to occur in the future. Likewise, procedures have been implemented to cross-train accounting personnel to prevent similar situations in the future. We continue to work with Board of Investments and Department of Administration personnel to ensure that all revenue and expenditure activity are properly recorded on the financial records.

Recommendation #2 – We recommend the department perform complete and timely reconciliations between the primary accounting records and POINTS to ensure the completeness and accuracy of the accounting records.

Concur. The department agrees with the importance of completing timely reconciliations between SABHRS and POINTS. The department's accounting staff and POINTS staff are currently working to identify and create information needed from POINTS to reconcile the two systems. Throughout this past fiscal year the department's accounting staff spent a great deal of time monitoring and reconciling transactions that passed to SABHRS from POINTS. Staff continue to work full-time on monitoring and correcting system defects so we can fully implement the department's integrated tax system and reconcile to the state accounting records.

The audit report references that the department has not been monitoring SABHRS reports that list POINTS financial information that was rejected and that accounting personnel did not know these reports existed and were not reviewing them. The reports identified are a tool used to verify whether batch jobs pass successfully from POINTS to SABHRS. They are not a source of accounting information to reconcile POINTS to the primary accounting records. Our Information Technology personnel have been using these reports since POINTS was implemented to ensure successful transmission to SABHRS.

Recommendation #3 – We recommend the department deposit receipts as required by state law.

Concur. We agree all payments should be deposited as required by state law. The delays in depositing money for the payments identified in the report were attributable to problems experienced with POINTS and unidentified payments received. We have

made the corrections to POINTS and changed our practice on handling unidentified payments to ensure timely deposits of all payments.

Recommendation #4 – We recommend the department comply with the state law by issuing refunds or credits to employers that overpay Unemployment Insurance taxes.

Concur. The Department acknowledges that very few refunds and credits have been issued since POINTS was implemented. This is due to defects in the accounting module of POINTS. Correcting these defects is the department's highest priority. It is anticipated the programs that will correct all defects in this area will be placed in production early in January 2001. After that occurs, when employers overpay their UI taxes, the department will be able to issue a refund or apply the overpayment to their account as a credit against future tax liabilities.

Recommendation #5 – We recommend the department:

A. Assess penalties and interest for UI in compliance with state law.

Concur. This situation is the result of defects in the accounting module of POINTS. Correcting these defects is the department's highest priority. It is anticipated the programs that will correct all defects in this area will be placed in production early in January 2001.

B. Analyze activity in the Special Revenue Penalty and Interest Fund to identify and make necessary adjustments to correct the accounting records.

Concur. The programming changes previously mentioned will provide the department the ability to electronically evaluate the penalty and interest fund and make identified corrections to the accounting records. Again, we anticipate that will be available by early January 2001.

Recommendation #6 – We recommend the department comply with federal law related to the immediate deposit of UI receipts in the U.S. Treasury clearing account.

Concur. The MTQ is a shared form for UI and Withholding Tax and includes penalty and interest that is not deposited in the federal account. Because the MTQ is remitted with one payment, the portion that pertains to UI can't be readily determined until the reported data is entered into POINTS. We are in the process of making changes to how these payments are processed to allow for immediate deposit in the federal account. We have met with representatives of the U.S. Department of Labor and they are aware of the process flaw and understand we are attempting to fix this as quickly as possible.

Recommendation #7 – We recommend the department:

A. Reasonably estimate volumes when calculating ISF rates to ensure rates are commensurate with costs.

Concur. We agree that we need to reasonably estimate volumes when calculating ISF rates to ensure they are commensurate with costs. Based on the information available to us in the last biennium we believe we reasonably estimated volumes. However, our estimates were not as accurate as they needed to be. This is primarily due to the fact that fiscal year 2000 was the first year of operation of the department's Customer Service Center (CSC), and we only had limited information and/or historical data to establish our estimates. In fact, the report states that our methodology for determining rates was reasonable. We will continue to refine our process of estimating volumes to ensure our rates are appropriate.

The department does plan to repay the inter-entity loan by fiscal year-end 2001. The commission revenue currently recorded on SABHRS for collections is not reflective of total commissions collected to date. A POINTS report is needed that provides information necessary to move the commission revenue from various accounts to the Internal Service Fund and we continue to work to generate this report. We continue to work on a separate defect in POINTS to allow the commission to be collected on delinquent accounts at the point of collection.

B. Charge for actual services provided to all customers using approved rates.

Concur. We agree CSC should charge all customers for services provided at approved rates. At the start of fiscal year 2000, procedures related to the CSC bills had not been finalized. The department was initially charged the appropriated amounts for the CSC services. CSC has since provided billing statements based on the actual volume of services rendered at the approved rates. We now have procedures in place for CSC to bill the department monthly at approved rates for actual services provided.

Recommendation #8 – We recommend the department:

A. Comply with its UI tax collection, reporting, and monitoring agreements with the DOLI.

Concur. We concur the department should comply with its UI tax collection, reporting, and monitoring agreements with the DOLI. Beginning in fiscal year 2001, the department is billing DOLI for UI activity on a monthly basis. Throughout the past fiscal year the department continued to refine its billing procedures and billed UI as these procedures allowed. The department accrued the expenditures related to employer field audit work at fiscal year-end and billed the DOLI for these audits in September 2000.

We have not been able to generate and submit to DOLI the ETA 581 report due to a POINTS defect. The department is aware of this issue and is addressing the concerns.

For UI audits performed by CVR, the department calculates a rate based on the level of effort necessary to complete UI work. This rate is included in the Fee-for-Service Proposal between the department and DOLI. The department bills DOLI for audits based on this agreement. Although the Cooperative Agreement entered into with DOLI

includes standards higher than the federal requirements, the department has met the federal standard of 2% audit coverage.

B. Comply with state law regarding spending non-general fund money first.

Concur. The department will request an inter-entity loan from the General Fund in order to record the initial transactions in the Federal Special Revenue Fund.

C. Comply with state policy related to expenditure accruals.

Partially Concur. As previously mentioned, the department accrued the expenditures related to employer field audit work at fiscal year-end and billed the DOLI for these audits in September 2000. The department established the accrual based on work that was completed, but had not been billed by fiscal year-end. Due to a defect in POINTS the audits could not be processed on the system. The department did conduct an analysis at fiscal year-end and was reasonably assured that the services provided, but not yet billed, would exceed the costs estimated in the "Program Operating Plan" entered into with DOLI. Written documentation has been provided to substantiate this transaction. Based on these estimates, and the fact that the audit work was complete, we believe it was only reasonable to accrue for these expenses. It was anticipated that these audits would be entered on the system, and they were, shortly after the end of the fiscal year.

Disclosure Issue – Revenues Collected by the Department of Revenue for Expenditures by Other State Agencies

We recognize this issue is provided to generate discussion of the methods currently used to report revenue on the state's accounting records. We provide the following comments on the issue.

In the first scenario the department is mandated by state law to collect and disburse various revenue tax collections. The current method of recording these transactions provides the department the audit trail necessary to demonstrate compliance with state laws regarding the recording and disbursement of these monies to the proper funds.

The second scenario relates to the Expendable Trust Fund, in which DOR collects unemployment insurance taxes on behalf of DOLI. DOLI is responsible for proper recording and use of this revenue; therefore, by fiscal year-end the revenue is properly reflected on DOLI's books.

The third scenario relates to the Internal Service Fund and services the Customer Service Center provides to other state agencies for a fee. The state agencies are responsible for recording and disbursing these funds to demonstrate compliance with state laws.

All three of the above scenarios are unique and require different treatment in order to allow the responsible agency to record and disburse revenues properly. The department will work with the Department of Administration to determine revenue recorded on the department's books complies with state policy and is consistent on a statewide basis.

Thank you for the professional work of your staff involved in the audit and thank you again for the opportunity to review the audit report and provide our comments in response.

Sincerely,

Mary Bryson

Mary Bryson
Director